

## **Bonding and Refunding**

### ***Background***

In December 1993, GASB adopted Statement No. 23, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities* (effective for periods beginning after June 15, 1994). The Statement establishes standards for the accounting and reporting of current and advance refundings in defeasance of debt by proprietary activities. Refundings involve the issuance of new debt whose proceeds are used to repay previously issued debt. The proceeds may be used immediately for this purpose (a current refunding) or may be placed in escrow and invested until they are used to repay the principal and interest on the old debt (an advance refunding).

Refundings of debt have become a common practice among governmental entities. Debt refundings allow governments to take advantage of lower interest rates and consequently lower the overall cost of debt financing. As a result, over the last ten years governments have refunded previous debt issues for both general obligation-type bonds and revenue bonds (normally associated with proprietary activities).

Given the limited scope of the proprietary activities of LEAs (e.g., food service, vending services, etc.), related debt (revenue bonds) is rare in the educational environment. Thus, the need for accounting guidance and related account codes to accommodate these transactions for school districts may not be necessary. Transactions of this type in the current environment are infrequent and could be considered exceptions to the practices of the majority of LEAs.

Under the new reporting requirements of GASB Statement No. 34, all future refundings in defeasance of debt transactions will be accounted for in a manner similar to the treatment currently in place for proprietary activities (Statement No. 23). While this issue is of little importance at this time, it is an issue which should be considered in the context of the new GASB reporting requirements (Phase II of this project).

### ***Accounting Treatment***

Under the requirements of GASB Statement No.23, the following basic accounting treatments for debt refundings in defeasance of debt have been established:

- For current refundings and advance refundings resulting in defeasance of debt reported by proprietary activities, the difference between the reacquisition price and the net carrying amount of the old debt should be deferred and amortized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter. On the balance sheet, this deferred amount should be reported as a deduction from or an addition to the new debt liability.
- For current refundings of prior refundings and for advance refundings of prior refundings resulting in defeasance of debt, the difference together with any

unamortized difference from the prior refundings, should be deferred and amortized over the shorter of the original amortization period remaining from the prior refundings or the life of the latest refunding debt (that is, the new debt).

Essentially, the Statement No. 23 requirements do not affect the account classifications utilized to record debt transactions for most LEAs. In most cases, the new requirements simply change accounting treatments for debt, while not affecting the actual accounts. However, for some LEAs (that issue proprietary fund bonds), Statement No. 23 requirements affects the recording and reporting of proprietary debt refundings.

In the context of debt transactions (including refundings in defeasance of debt), LEAs utilize several Handbook accounts including:

*Liability Accounts*

- 442 (Bonds Payable)
- 443 (Unamortized Premiums on Bonds Sold)
- 455 (Interest Payable)

*Expenditure/Other Uses Object Codes*

- 830 (Interest)
- 910 (Redemption of Principal)
- 940 (Payments to Escrow Agents)

Based on the new accounting treatments and reporting requirements, we believe these codes generally are sufficient to record and report debt refunding transactions. However, based on Handbook Committee feedback, we are proposing to add an account for Unamortized Losses on Debt Refundings. This account will be used to record the unamortized portion of losses from debt refundings for proprietary funds only.

The need for guidance on the accounting treatments and reporting requirements for debt transactions by LEAs should be a topic that is explored in Phase II of this project. The proper accounting treatment for investment transactions should be addressed in the context of more global changes to the Handbook that will be explored at that time (in consideration of GASB Statement No. 34 requirements).

***Proposed Handbook Revision***

We recommend the addition of the following liability account:

**444. Unamortized Losses on Debt Refundings**

An account which represents the difference between the reacquisition price and the net carrying amount of old debt when a current or advance refunding of debt occurs. This account should be used only when defeasance of debt occurs for proprietary funds. The unamortized loss amount should be deferred and amortized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter. On the balance sheet, this deferred amount should be reported as a deduction from or an addition to the new debt liability.

### ***Coding Examples***

1. An LEA conducts a current refunding of bonds that were issued ten years ago to finance a sports stadium. The bonds were issued as revenue bonds to be repaid from the income from the stadium. The net carrying amount of the old bonds is \$10,500,000 (with no unamortized debt issuance premiums). The reacquisition price of the old debt is \$10,500,000. The new debt results in a total liability of \$11,000,000 with no premium or discount.

In order to record the transactions, the LEA would credit the Bonds Payable account (442) for \$500,000 (the difference between the net carrying amount of the old debt and the cost of the new debt) and debit the Unamortized Losses on Debt Refundings account for \$500,000. The unamortized loss would be amortized over the life of the new or old debt whichever is shorter.